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BVI's[1] requests with regard to the EU Commission's proposal for a Directive on Corporate Sustainability Due Diligence (CSDDD)

BVI supports the EU initiative for establishing binding rules on sustainable corporate due diligence. Already in 2013, the German fund industry agreed on common principles for responsible investing that have since then been enshrined in chapter V of the BVI Rules of Conduct[2]. Under the BVI Rules, asset managers are, inter alia, obliged to monitor governance of their portfolio companies and be transparent about their exercise of shareholder rights and dialogue with portfolio companies to promote responsible governance and value enhancement. Since 2013, the market for responsible investments in Germany has thriven, with assets under management attributable to funds with sustainability features having multiplied and nearly reaching EUR 600 bn by end 2021.[3]

BVI members are committed to the objectives of the EU Action Plan for facilitating sustainable growth. Most of them are increasingly integrating sustainability criteria in their investment strategies and engaging with portfolio companies in order to foster sustainable development and transition. Therefore, we perceive the CSDD initiative as an essential element of the EU sustainable finance strategy and a substantive counterpart to the sustainability-related reporting requirements under CSRD. It also represents a key response to the duties of fund managers and other financial market participants under SFDR to work towards mitigating principal adverse impacts on sustainability matters stemming from their investments in investee companies.

At the same time, fund managers will be affected by the envisaged CSDD framework in their own business operations, provided they reach the relevant thresholds defining the scope of application. In view of this double perspective – as investors in impacted companies on the one hand and as business undertakings on the other – we also share the widespread concerns about the cost-benefit-ratio and potential detriments for the competitiveness of the European industry in the global context. Due to the large number of EU regulatory initiatives in the sustainable finance space, the regulatory landscape has grown very complex. A more streamlined regulatory approach to the basic concepts underlying the EU regulations would be most helpful for enhancing understanding among the affected market participants, avoiding inconsistencies and overlaps and reducing the implementation burden for companies and investors.

Against this background, we have identified the need for the **following targeted improvements** of the EU proposal that will help to **reduce redundancies** and to **enhance the effectiveness of CSDDD** in the upcoming legislative process:

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.
[2] Rules of Conduct (bvi.de)
[3] Source: BVI statistics (cf. Snapshot Sustainability for Q4 2021)

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1. Clear delineation of scope between CSDDD and SFDR

Large asset managers and other institutional investors such as insurance companies and pension funds are already required by the SFDR framework to adopt due diligence policies for identifying principal adverse impacts of their investment decisions in investee companies.[4] Principal adverse impacts under SFDR shall be measured by means of at least 15 standardised indicators covering major sustainability topics such as GHG emissions, water, waste, biodiversity as well as social and human rights issues.[5] Asset managers need to identify these impacts for each and every decision to invest in companies and to consider them as part of their investment process based on sectoral rules for UCITS and AIFs.[6] In future, they will also be bound to report on principal adverse indicators as well as on actions taken and planned to avoid or reduce the principal adverse impacts identified in their managed portfolios. Such detailed reporting is expected to start in mid-2023 for the reporting period 2022.[7]

Hence, it should be clear that **both principal adverse impact rules under SFDR and due diligence rules under CSDDD are aiming to tackle the same problem**, namely preventing potential or reducing actual adverse impacts on people and the planet. However, while the **SFDR rules are tailored to companies in their role as investors**, **the CSDDD provisions focus on business relationships and companies' day-to-day operations**. For instance, contractual assurances from business partners for ensuring compliance with a company's code of conduct which represent a core element of sustainable due diligence under CSDDD are clearly not practicable in investment situations, especially in case of minority free float shareholdings in listed companies. Instead, actions envisaged under SFDR for avoiding or reducing principal adverse impacts are more targeted towards engagement activities such as exercising voting rights as shareholder, sending letters or attending meetings with the management of investee companies, participating in shareholder dialogues with specific sustainability objectives and planning escalation measures in case those objectives are not achieved, including reduction of investments or exclusion decisions.[8]

Therefore, there is a **need for a clear delineation of scope between SFDR and CSDDD requirements for identifying and preventing or reducing adverse impacts**. **Actions in terms of principal adverse impacts of investment decisions in investee companies should be governed exclusively by SFDR**, whereas the CSDD framework should pertain to business relationships in a company's operations. For asset managers, this would mean that CSDDD should apply to the business relationships with their contractors, delegates and clients, whereas investment activities on behalf of their clients would fall under SFDR. Such delineation would cause **no compromise for the level of protection** given the comparable scope of application for financial market participants under both frameworks (application to large financial undertakings with more than 500 employees and focus on direct clients/investee company in question).

We request supplementing recital (19) of the draft Directive on application to regulated financial undertakings by a sentence clarifying that adverse impacts arising from investment decisions in investee companies are to be dealt with under SFDR rules and consequently, are not subject to CSDDD requirements.

[4] Article 4 (1)(a), (2-4) SFDR.
[5] Article 6 (1) in conjunction with Annex I Tables 1 to 3 of the draft RTS to SFDR.
[6] Article 23 (6) of UCITS Delegated Directive 2010/43/EU, Article 18 (6) of AIFM Delegated Regulation (EU) 231/2013.
[7] Articles 4, 6 (2) of the draft RTS to SFDR.
[8] As set out in recital 16 of the draft RTS to SFDR.

2. Understanding and reporting of adverse impacts should be better aligned

As explained above, the CSDD initiative is not the only EU framework that aims at preventing and reducing adverse impacts on sustainability. The SFDR framework sets out detailed due diligence obligations for consideration of principal adverse impacts in the investment decisions by financial market participants, whereas the companies' reporting duties with regard to actual and potential adverse impacts are to be laid down under the new CSRD regime.

Given this interconnection, it is **crucial to apply consistent concepts and definitions for relevant adverse impacts across all EU frameworks** addressing different actors and activities. First of all, this should involve a clearer **distinction between principal and other adverse impacts** as well as actions required in either terms. Moreover, companies should **apply the same definitions and metrics** for both actions under CSDDD to identify and prevent or mitigate adverse impacts and reporting on these measures under CSRD. Investors, in turn, should be able to rely on the indicators and other information published by companies for assessing principal adverse impacts associated with their investments.

The CSDDD proposal relates the understanding of adverse impacts to violations of rights and prohibitions included in environmental conventions and international human rights agreements. Under SFDR, on the other hand, principal adverse impacts are to be identified and monitored on the basis of standardised sets of indicators covering also environmental, social and other human rights issues. There is an **urgent need to link these two concepts** in order to enhance understanding among companies and investors and to make information exchange as efficient as possible. In our view, this should happen **under the CSRD framework by translating the identified adverse impacts into standardised metrics and reporting on principal adverse impacts by means of identical KPIs** that are to be used by investors under SFDR.

A dedicated recital should be added to the CSDDD to explain the interlinkages with CSRD and SFDR and to oblige the EU Commission to provide for a harmonised set of criteria and metrics for (principal) adverse impacts under all three EU frameworks.

3. Intended reliefs for finance sector companies must be feasible

We appreciate the general awareness for the specificities of the financial services sector that is manifested in a handful of particular rules for regulated financial undertakings. However, these rules must be feasible in the overall context of sustainable due diligence in order to attain their eventual intention of providing relief. This pertains in particular to the proposed derogations under Articles 7 (6) and 8 (7) of the draft Directive. It appears that while financial market companies shall not be required to terminate a contractual relationship in case an adverse impact cannot be effectively prevented or mitigated, they will still be subject to full civil liability under Article 22 (1) unless they are able to prove that such termination would have been "reasonably expected to cause substantial prejudice" to their business partner. Given the nature of such derogation as relief from the general standard, we would expect that the burden of proof would lie with the financial undertaking. Under such circumstances, it is hard to imagine that any financial undertaking would be ready to bear the liability risk and make use of the derogation.

Bearing in mind that the proposed derogation shall ensure basic access to funding and other financial services, additional safeguards for regulated financial undertakings are necessary. These should include, in particular, (1) clarification of circumstances under which "substantial prejudice" can be "reasonably expected and (2) extension of the rule in Art. 22 (2), first subparagraph of the draft Directive to cover legitimate use of the derogation based on the clarifications suggested above.

4. Escalation process needs to duly consider dependencies in the value chain

In general, we support the six steps of the sustainable due diligence process as outlined in Article 4 (1) of the draft Directive. As regards the proposed measures for preventing potential or neutralising/ minimising actual adverse impacts, however, the CSDD framework should account for potential dependencies in the value chain. In various industry sectors there will be instances where key services are being provided only by a few companies or key components are available only from a few suppliers. In the financial services sector, such dependency has existed for a long time in relation to credit agencies and is currently growing as regards ESG data vendors. Commercial providers have a quasi oligopoly on provision of company-related and other ESG data needed e.g. by asset managers in order to manage sustainability risks and deal with principal adverse impacts associated with their investments. In addition, without data supply by commercial vendors, financial industry would be currently not in the position to fulfil regulatory reporting requirements relating e.g. to the PAI statement or to reporting of Taxonomy quota under SFDR and the Taxonomy framework.

Market concentration in the ESG data business has significantly increased over the last years, in particular due to strategic acquisitions. All leading ESG data and research providers (such as MSCI, Morningstar - which acquired Sustainalytics in 2020, and Vigeo-Eiris, the biggest according to market share) are now either headquartered in the US or owned by US company groups with the exception of ISS ESG that belongs to the Deutsche Börse group. This situation is already challenging for ensuring quality and reliability of data in line with the EU regulatory requirements, but it might also become very problematic in case the relevant service providers were not willing to commit to the relevant environmental and human right conventions.

It is also clear that the CSDDD while promoting sustainable corporate governance must strike the right balance between the need for credible due diligence along the value chain and the ability of companies operating in the Single Market to remain competitive also for servicing the needs of their non-EU clients. Situations should be avoided where clients from non-EU countries must be turned down because their request e.g. in terms of onboarding certain index providers or asset managers from third countries cannot be met. These clients will then obviously turn to non-EU asset managers or other financial undertakings without significant business operations in the EU who will not be confined by the CSDD rules and will remain flexible to meet the clients' requests.

Therefore, it is appropriate to provide for certain limited exceptions from the last step of the escalation process according to Articles 7 (5) and 8 (6) of the draft Regulation which should apply in the following circumstances:

- **Provision of goods or services that cannot be reasonably obtained from other providers on comparable conditions, especially in terms of access, quality and timing,**
- **Explicit requests by clients, especially from outside the EU, to cooperate with specific counterparties for provision of goods or services.**

5. Impact on remuneration needs to be clarified

We agree that variable remuneration of a company's directors should be appropriately linked to the attainment of relevant sustainability targets and progress in transition. In fact, the market has already anticipated this development to a large extent. The number of listed companies incorporating ESG metrics into their variable remuneration arrangements has increased rapidly in recent years.

The CSDD initiative should thus seize the opportunity to set clear regulatory expectations in this regard. The current wording of Article 15 (3) appears too cautious since it provides for an exit option for companies that take no particular interest in ESG matters to refrain from linking variable remuneration especially to long-term interests and sustainability aspects. On the other hand, the wording should be more focused on executive remuneration. There is a widespread consensus among investors that incorporation of ESG metrics into variable remuneration arrangements is appropriate for executive directors responsible for implementing a company's business strategy.

Our suggestion with regard to Art. 15 (3) of the draft Directive is therefore (1) to clearly require that the fulfilment of the obligations on planning transition to a sustainable economy and, where relevant, with limiting of global warming in line with the Paris Agreement is duly taken into account when setting variable remuneration and (2) to focus this requirement on remuneration of executive directors.

6. Compliance with new directors' duty of care needs to be reported

Investors need to be able to hold directors accountable for their compliance or non-compliance with the extended duty of care as proposed under Article 25 (1) of the draft Directive. Without corresponding disclosures, there will be very limited possibility for asset managers and other investors to assess whether the consequences for sustainability matters have been duly taken into account in the business decisions. We believe that such disclosures should be covered by sustainability reporting under Articles 19a and 29a CSRD and should be expected as part of the information on how the undertaking's strategy takes account of the interests of its stakeholders and of the impacts on sustainability matters.

The link to the relevant part of sustainability reporting under CSRD should be emphasised by way of a suitable recital.